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SUBJECT: KUWAIT RESPONSE: BARRIERS TO OIL INVESTMENT

REF: SECSTATE 189760

¶1. Summary: The entire local oil industry in Kuwait is state-run and the Kuwait Constitution expressly forbids foreign companies from investing in the natural resources of the country. U.S. companies can neither purchase local oil companies nor obtain equity oil. There are some very limited opportunities for investment in the refining and petrochemical sector. While there is no law expressly forbidding the marketing of petroleum products by foreign companies, the subsidies provided for local products make it virtually impossible for any company to profitably import petroleum products. End Summary.

Purchase of Local Oil Companies Or Equity Oil Not Allowed
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¶2. U.S. oil companies have been active in Kuwait since the 1930s, when the Gulf Oil Corporation (later merged into Chevron) first discovered oil in 1938 in the Burgan field, the world's second-largest oilfield. Kuwait nationalized its oil industry in 1975 by purchasing the interests of the international oil companies and foreign companies have been barred from direct ownership of any local natural resources since that time. This includes a restriction on ownership of companies and/or ownership or control of indigenous oil reserves.

Joint Petrochemical Venture Only Current Outlet for U.S. FDI
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¶3. In the petrochemical sector, the one instance in which a U.S. company has been allowed to invest in a local production facility is in the Dow Chemical - Petrochemical Industries Corporation (PIC) joint venture known as EQUATE. Originally established in 1995 as a joint venture between PIC and Union Carbide, Dow Chemical later acquired Union Carbide and is now an active partner in the venture. PIC and Dow both hold a 42% stake in the venture, with 10% held by the Boubyan Petrochemical Company and 6% held by Al-Qurain Petrochemical Company, both publicly traded companies on the Kuwait Stock Exchange. The company produces polyethylene and ethylene glycol, which are marketed primarily to Asia, Europe and the Middle East. The venture has been extremely profitable for Kuwait, opening the GOK's eyes to the potential of its petrochemical sector. Three new projects - an Aromatics plant, a second Olefins project and a Styrene plant - will bring together the original three investors again, allowing Dow a bigger foothold in the market.

Investment in Refineries Not Allowed, Yet

¶4. Although the current refining capacity is completely GOK-owned and operated, a new planned fourth refinery holds out the prospect of private investment in the refining sector. It is not yet clear whether this private investment would be limited to Kuwaiti participation. It remains unclear who would invest in a sector not seen as very profitable and how much management control they would actually be given. Recent discussions concerning possible Kuwaiti investment in U.S. refining capacity may provide an opportunity to broach the subject of reciprocal investment by U.S. companies in the Kuwaiti refining sector.

Marketing Allowed, But Who Would Bother?

¶5. Kuwaiti law forbids foreign companies from investment in the exploration and production of petroleum products in Kuwait, but does not expressly forbid the marketing of petroleum products. The subsidies provided by the GOK for local fuel products, however, would make it virtually impossible for any company to profitably import products and compete with the local products. (Note: Other foreign products, such as lubricants and motor oils, are available and sold in the local market.) Super unleaded gasoline, for example, is price-controlled and sells for $0.84/gallon. The Kuwait National Petroleum Company (KNPC), which runs the gasoline stations throughout Kuwait, is in the process of privatizing its 120 gas stations and creating three competing chains of 40 stations each, with local private investment. Foreign direct investment in these newly privatized gas stations is not currently allowed.

Commercial Framework for U.S. Involvement in Energy Sector

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¶6. No commercial framework exists for U.S. or other foreign company involvement in the energy sector. The Kuwaiti Constitution specifies, in Article 21, that "natural resources and all revenues there from are the property of the State. It shall ensure their preservation and proper exploitation." Article 70 of the Constitution specifies that any "treaties" involving natural resources must be ratified as a law by the National Assembly. Article 152 further specifies that "no concession for exploitation of a natural resource may be granted except by a law and for a limited period."

¶7. Recognizing the need for foreign technical expertise in its oil sector but wanting to set limits on the actual participation of the companies, the GOK promulgated law number 67 of 1964 which deals with public energy sector tenders. The Kuwait Oil Company (KOC) added a number of stipulations to this law, concerning the conditions for foreign companies to be contractors for the oil sector. The stipulations include: that the company participates through a public tender; that the company is represented by a Kuwaiti agent or partner; that the company must abide by GOK labor rules, including mandatory hiring quotas for Kuwaitis; and that any disputes between the contractor and KOC come under the exclusive jurisdiction of the Kuwaiti courts. A number of foreign oil companies, including U.S. companies, have technical service contracts with various elements of the GOK oil industry.

¶8. In 2001 the National Assembly approved a Foreign Investment Law which permits 100% foreign ownership of local companies in certain sectors. In 2003 the law was clarified and the specific sectors where 100% foreign ownership would be allowed were identified. Oil and gas exploration and/or production was ruled as off limits and not eligible for a foreign investment license.

¶9. The Parliament is expected to vote this session on a law

enabling KOC to sign an Operating Service Contract (OSC) with a consortium of foreign oil companies. This law would permit foreign experts to further develop and exploit Kuwait's northern oilfields. If the bill passes, KOC will present a contract document to three consortia, each of which includes a U.S. company. The consortia will bid on this contract and the winning consortium will be granted the right to operate the northern oilfields. The winning consortium is expected to make investments totaling $7 to $8 billion for development of the fields and management of the reservoirs over the lifetime of the proposed twenty-year contract. The consortium's return will be cost recovery plus a per-barrel fee. Although this law appears not to contravene the Constitution, the project has been mired in controversy for almost ten years. Some parliamentarians and others view the proposal as permitting foreign companies control over Kuwait's natural resources.

Cumulative and Annual Inflows of U.S. FDI

¶10. The only recent U.S. FDI in the oil and gas sector would be Union Carbide's 42% contribution to the $2 billion EQUATE petrochemical plant and facilities in 1995, and then it and Dow Chemicals' contribution to facilities upkeep and maintenance. The joint venture achieved its first profitable quarter in December 2000, and has been profitable since, so the actual inflow of additional investment into the facility by Dow is minimal. With the three new joint venture petrochemical projects expected to begin construction soon, we can expect additional inflows of U.S. FDI over the next few years.

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